

General Information Letter: 4 U.S.C. Section 114 prohibits Illinois from taxing retirement benefits of nonresidents.

February 27, 2002

Dear:

This is in response to your inquiry regarding the Illinois income tax treatment of deferred compensation received by MR. Z, SSN XXX-XX-XXXX. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at [www.revenue.state.il.us](http://www.revenue.state.il.us).

You have represented that MR. Z is a resident of the State of Arizona. You have provided me with a copy of a Uniform Player's Contract between COMPANY and MR. Z, executed on January 19, 1984, together with various amendments. The Third Amendment to Addendum II to the contract provides that, in lieu of the deferred compensation provision in the original contract:

The Deferred Compensation shall be payable as follows: (i) \$X shall be paid on December 31, 1990; (ii) \$X shall be paid on January 5, 1991; and (iii) the remaining \$X shall be paid in 15 consecutive equal installments of \$X commencing on July 15, 1995, and continuing on July 15 of each year thereafter until July 15, 2009.

COMPANY has been withholding Illinois income tax from the payments of deferred compensation made under this provision.

You have asked whether the deferred compensation MR. Z receives under this contract while a nonresident of Illinois is subject to Illinois income taxation or to withholding of Illinois income tax.

### **Response**

As a general rule, deferred compensation of a nonresident employee is presumed to have been earned ratably over the employee's last 5 years of service to the employer, and is allocated to (and taxed by) Illinois in the same proportion as the compensation paid during those 5 years was allocated to Illinois. See 86 Ill. Admin. Code Section 100.3120(b)(1). Even when deferred compensation of a nonresident is allocated to Illinois under this provision, however, no withholding of Illinois income tax is required. See 86 Ill. Admin. Code Section 100.7010(g)(1). Accordingly, COMPANY should not be withholding Illinois income tax from its payment of deferred compensation to MR. Z.

Notwithstanding the allocation rule in 86 Ill. Admin. Code Section 100.3120(b)(1), 5 U.S.C. Section 114(a) provides:

No State may impose an income tax on any retirement income of an individual who is not a resident or domiciliary of such State (as determined under the laws of such State).

5 U.S.C. Section 114(b)(1), subparagraphs (A) through (H), define "retirement income" for purposes of this prohibition to include payments made under qualified retirement plans eligible for special tax treatment under the Internal Revenue Code. In addition, 5 U.S.C. Section 114(b)(1)(I) provides that "retirement income" includes:

any plan, program, or arrangement described in section 3121(v)(2)(C) of [the Internal Revenue Code], if such income –

(i) is part of a series of substantially equal periodic payments (not less frequently than annually) made for –

(I) the life or life expectancy of the recipient (or the joint lives or joint life expectancies of the recipient and the designated beneficiary of the recipient), or

(II) a period of not less than 10 years.

Section 3121(v)(2)(C) of the Internal Revenue Code defines a "nonqualified deferred compensation plan" as any plan not described in Section 3121(a)(5). Section 3121(a)(5) contains a list of qualified plans that is identical in all relevant respects to the listing of plans that constitute "retirement income" under 5 U.S.C. Section 114(b)(1), subparagraphs (A) through (H).

Accordingly, assuming the deferred compensation paid by COMPANY to MR. Z does not constitute retirement income exempt from Illinois income taxation under some other subparagraph of 5 U.S.C. Section 114(b)(1), it will be exempt from Illinois income taxation under subparagraph (I) because it is payable in equal annual installments for a period of more than 10 years.

As a nonresident, MR. Z is therefore not subject to Illinois income tax on the deferred compensation he receives under the contract you sent me, and COMPANY should not be withholding Illinois income tax from the payments made under that contract.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton  
Deputy General Counsel -- Income Tax